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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-596

HOWARD BERSCH,

Petitioner,

v.

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR ARTHUR ANDERSEN & CO. IN OPPOSITION

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November 6, 1975

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Questions Presented for Review

(1) Did the Court of Appeals misapply the federal securities laws and commit error when it held that their anti-fraud provisions do not apply to the sale to non-resident aliens of the United States of the securities of a foreign corporation, which does not have an office in the United States; whose securities are not traded in the United States; where all sales of its securities were made outside the United States; where the prospectuses were prepared, printed and delivered in foreign countries; where the stock was deliv-

ered and paid for in foreign countries; and where the loss suffered by such non-resident aliens was not caused either by an act committed within the United States or by a culpable failure to act within the United States?

(2) Did the Court of Appeals abuse its discretion and commit error when it held that a purported class consisting of 100,000 purchasers of stock of a foreign corporation, 99.65% of which consists of non-resident aliens who bought their stock abroad in countries such as Europe, Asia, Africa, Australia and South America, is not manageable and, accordingly, directed elimination from the class of all such non-resident aliens?

Statement of the Case

I.O.S., Ltd. ("IOS"), which made three public common stock offerings in September 1969, by three separate prospectuses, is a foreign corporation with its principal office in Geneva. It never had an office in the United States and its stock was never listed on a stock exchange in the United States or traded over the counter in this country. Before such public offerings, there was no market for IOS common stock anywhere in the world, and there has never been a market for such stock in the United States.

Furthermore, as the Court of Appeals stated (6b-7b),* on May 23, 1967, IOS and its affiliates were barred by an SEC order from engaging in any activity subject to its jurisdiction and from selling securities to United States citizens or nationals wherever located, except that sales could be made outside the United States to IOS insiders, such as officers, directors and full-time personnel (192A—109A-118A).**

* References to ("——a") and ("——b") are to the appendix to the petition.

** References to ("——A") are to the four-volume appendix before the Court of Appeals.

Respondent Arthur Andersen & Co. ("Andersen"), an international accounting firm, is sued since its Zurich office audited the IOS financial statements and consented to use of Andersen's reports in the prospectuses (178A).

One of the three September 1969 public offerings consisted of a primary offering of 5,600,000 shares underwritten by Drexel Harriman Ripley, a Wall Street firm ("Drexel"), Banque Rothschild of Paris, Hill, Samuel & Co., Limited, of London, Guinness, Mahon & Co. Limited of London, Pierson, Heldring & Pierson of Amsterdam, Holland, and Smith, Barney & Co., also a Wall Street firm (168A). There were 116 additional firms in 44 countries in Europe, Asia and Australia which acted as underwriters and dealers in the sale of the IOS stock in their respective countries (175A-176A). While 25 of such 116 firms were American, their solicitation and selling activities took place entirely outside the United States, as required by an agreement to limit all such activities to areas in Europe, Asia and Africa.

The Drexel prospectus stated on its cover page that the shares were not registered under the federal securities act and were not being offered in the United States, Canada or Mexico, and were not being offered to United States nationals or citizens who resided abroad, or to United States residents, or to IOS directors, officers or full-time employees (168A). The District Court found that "no sales to Americans did occur" through the Drexel offering (18a).

There was a secondary offering in Canada of 1,450,000 shares underwritten by Canadian firms managed by defendant J. H. Crang & Co., a Toronto financial house ("Crang").* The District Court found that Crang "sold shares only outside the United States and only to non-Americans" (23a).

* The complaint was dismissed as against Crang for lack of *in personam* jurisdiction (49b), and review of such dismissal has not been sought by petitioner.

The third offering, also secondary, covered 3,950,000 IOS shares underwritten by an IOS subsidiary, Investors Overseas Bank, Limited ("IOB"), a Bahamian corporation. This offering was limited to IOS insiders, such as IOS officers, directors and employees, as authorized by the SEC order of May 23, 1967, and was made in Europe, Asia, Africa, Australia and South America. Like the Drexel prospectus, the IOB prospectus also stated on its face that the shares were not registered under the federall securities act and were not offered in the United States, Canada or Mexico (184A).

The prospectus for the Drexel offering was prepared outside the United States and, as the Court of Appeals noted, was "printed abroad in English, French, amd German and delivered to the purchasers outside the United States" (8b). However, as stressed in the petition for certiorari, as a basis for claiming subject matter jurisdiction, discussions of a preliminary nature as to the proposed Drexel offering were held in New York, and the wording of a "sticker affixed to the cover of the prospectus" (Pet. 12), consisting of a few lines, was prepared in New York.

The prospectuses for the Crang and IOB offerings were also prepared, printed and delivered outside the United States.

Petitioner Bersch, an IOS insider, subscribed for 600 shares at $10 a share under the IOB offering, claiming, however, that before buying he "read all three prospectuses in New York" (Pet. 14).* Bersch seeks to represent a class of 100,000 purchasers under all three offerings. Since he claims that 360 class members are United States citizens (Pet. 14), the remaining 99,640 class members, or 99.6% of the putative class, are non-citizen aliens who bought stock in Europe, Africa, Asia, Australia and South America.

* Since Bersch subscribed and paid for his shares on September 3, 1969, 21 days before the date of any of the three prospectuses (47A-1), there is doubt as to the truthfulness of his statement that he read all three prospectuses before making his purchase.

The discovery in this case, consisting of depositions on oral examination and document production, did not deal with the merits, but was limited to petitioner's efforts to uncover and marshal every act of any nature performed by any defendant in the United States upon which he could base a claim under the federal securities laws to establish subject matter jurisdiction. The petition discusses at length petitioner's version of the acts which may or may not have been performed in the United States (Pet. 5-15). The Court of Appeals, which had before it all the results of petitioner's discovery, found that "none of the defendants engaged in significant activities within the United States"; that, with respect to respondent Andersen, the accounting firm, there was a "paucity of physical acts on its part in the United States"; and that the activities within the United States relied on by petitioner were "merely preparatory activities" (33b).

As shown below, the Court of Appeals' decision turned on the factual situation elicited in such discovery proceedings, on the basis of which it concluded that the federal securities laws did not apply to the non-resident aliens who bought the stock of this foreign corporation in sales made abroad because under the particular set of facts here presented their loss was not caused by any act or culpable failure to act within the United States (35b).

Reasons for Denying the Petition

(1) There is no conflict between Circuits.

The petition suggests a possible conflict between the Second Circuit decision below that the antifraud provisions of the federal securities laws do not apply to the foreign transactions here involved and the Eighth Circuit decision in *Travis* v. *Anthes Imperial Limited*, 473 F.2d 515 (8th Cir. 1973). For the petition states that in the *Travis* case "The

Eighth Circuit was 'persuaded' that Section 10b would be applicable, even if it were assumed that all the fraudulent dealings took place in Canada" (Pet. 24). The *Travis* case, however, is not a decision "on the same matter" as the decision here sought to be reviewed,—the specific requirement of this Court's Rule 19.1.(b). If it were, the 77-page* petition for certiorari would have made much more than mere passing reference to the *Travis* case.

(2) The case does not present an important question of federal law which should be settled by this Court.

Also, the decision of the Court of Appeals is correct in all respects.

The petition appears to rest primarily on the provision of Rule 19.1.(b) that the Court of Appeals "has decided an important question of federal law which has not been, but should be, settled by this court."

The petition states that there is "a dearth of judicial interpretation" in this area (p. 20), but elsewhere contends that "the law in this area is both unsettled and confused" (p. 26). The petition further states that "the securities statutes fail to define their extraterritorial reach" so that there is an *"absence of express legislative direction"*** (pp. 19-20), but elsewhere contends that the Court adopted "a discriminatory and dangerous interpretation of those statutes, *in conflict with the language of the statutes"* (pp. 3-4). Accordingly, the petition asks "that this Court express its views on the issue of the extraterritorial reach of the federal securities laws" (p. 26) and define "the reach of the federal securities laws", so that "both Americans and foreigners engaged in international securities transactions" would be put on notice "as to what conduct and circum-

* It would suffice to deny the petition that, in consisting of 77 pages, it violates the Rule 23.4. requirement of "brevity." See, for example, *Kennemer* v. *Billington,* 323 U.S. 709 (1944).

** Italics throughout are supplied.

stances American courts will deem sufficient to warrant the exercise of jurisdiction" (p. 28). In short, petitioner wants this Court to write a mini-treatise or handbook on the extraterritorial reach of the federal securities laws as a guide to all future foreign securities transactions, though such future transactions may take forms and involve circumstances vastly different from those at bar and which cannot now be envisaged. Obviously, this Court cannot be expected to prepare such an exposition of the extraterritorial scope and reach of the federal securities laws, especially on the basis of the limited factual situation and narrow issue here presented and decided by the Court of Appeals (as shown below, p. 8, *infra*); namely, whether or not the loss to foreigners in this particular foreign offering was directly caused by "acts (or culpable failures to act) within the United States" (35b).

Any "dearth" of judicial opinion as to whether the federal securities laws apply to foreign sales by foreign corporations of their shares to nonresident aliens of the United States exists because it has, undoubtedly, rarely occurred to anyone even to claim that the federal securities laws apply to entirely foreign transactions where no act within the United States caused the loss.

Judge Friendly's opinion, after careful analysis of the special factual situation here presented, plainly stated the law, which is neither "unsettled" nor "confused" (Pet. 26), as follows (34b-35b):

> "We have thus concluded that the anti-fraud provisions of the federal securities laws:
>
> "(1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
>
> "(2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the

United States have significantly contributed thereto; but

"(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses".

Such conclusion (3) as to "losses from sales of securities to foreigners outside the United States" was reached in the context of a foreign corporation which does no business in the United States, with all the prospectuses prepared, printed and delivered abroad, and with the sales consummated abroad.

Since the Court of Appeals merely directed elimination from the class of "all purchasers other than persons who were residents or citizens of the United States" (43b), allowing the case to continue in behalf of both resident and non-resident American buyers (subject to certain class action problems as to which "further factual inquiry is needed" (43b)), its holding, which the petition urges "will constitute erroneous and dangerous precedent" (p. 30), is merely as follows: The federal securities laws do not apply to sales to non-resident aliens by foreign corporations made outside the United States, where no act or culpable failure to act within the United States directly caused loss to the purchasers.

Petitioner, however, wants this Court now to prescribe a rule of law to the effect that if, for example, a French corporation, through an American underwriter acting through its French branch, sold its securities to French citizens resident in France, with the sale consummated entirely in France, on the basis of a prospectus prepared, printed and delivered in France, such French citizen is protected by the United States securities laws and may sue in the United States District Court for any loss suffered by him, if some insignificant work of a preparatory nature was performed in the United States, even though no act or culpable failure

to act, which directly caused such loss, occurred within the United States. The petition urges that the federal court must reach out and assume jurisdiction in such a case because "the United States has a peculiar responsibility of leadership" (Pet. 27).

While the petition is replete with *ipse dixit* statements of "the Congressional will" and the "legislative intent", without any reference to legislative history, it is self-evident that Congress could never have intended such a result and that such a result not only makes no sense but would be contrary to anything ever decided in any area of law as to the extraterritorial application of a United States statute. For any Court to adopt petitioner's position would, to quote petitioner, "constitute erroneous and dangerous precedent" (Pet. 30).

(3) Petitioner has misstated the position of the SEC.

Petitioner, deeming it "significant" that the Court of Appeals "did not seek advice from the SEC", states, without support in the record, that if asked the SEC would have deemed that the antifraud provisions of the securities laws "attached to the challenged transaction herein" (Pet. 37, fn.). However, the SEC is not reticent about expressing its views, as *amicus curiae,* to help achieve a desired result. Thus, in *IIT* v. *Vencap, Ltd.,* 519 F.2d 1001 (2d Cir. 1975), decided by the same panel of the same Court on the same day as the case at bar, the SEC submitted a brief *amicus curiae* in support of application of the federal securities laws to the situation there involved. But though the SEC was fully familiar with the case at bar, it did not submit a brief or take the position that the federal securities laws apply to the sale of IOS shares made abroad to non-resident aliens. Indeed, SEC rulings indicate the contrary.

The SEC has made it clear that registration is not required for offerings of United States corporations to foreign investors. SEC Release No. 33-4708 and No. 34-

7366, dated July 9, 1964, 17 C.F.R. §231.4708, 1 CCH Fed. Sec. Rep. ¶1362, quoted by the Court of Appeals (9b, fn. 12), state:

> "The Commission has traditionally taken the position that the registration requirements of Section 5 of the Act *are primarily intended to protect American investors.*"

Accordingly, the releases provide that the foreign nature of an offering and its exemption from registration is not affected by

> "whether the offering originates from within or outside the United States, whether domestic or foreign brokerage dealers are involved, and whether the actual mechanics of the distribution are effected within the United States, *so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.*"

Clearly, if a foreign offering of a domestic corporation is not subject to SEC registration requirements because the Act is "primarily intended to protect American investors," *a fortiori* would the foreign offering of a foreign corporation be exempt, even though in this case, contrary to what in fact occurred, the actual mechanics of the distribution had been effected within the United States.

Petitioner argues, however, that the SEC exemption from registration does not affect liability under the antifraud provisions. Whatever application such provisions may have to foreign offerings of foreign corporations, where acts within the United States caused the loss, clearly such provisions do not apply to losses from sales of securities of foreign corporations made to foreigners outside the United States where, as the Court of Appeals here found, the loss was not caused by any act or culpable failure to act within the United States.

As already noted, the petition distorts the record when it states that the SEC considers that the antifraud provisions of the securities laws "attached to the challenged transaction herein" (Pet. 37fn.). The SEC merely takes the position that the fact that an offering may be exempt from registration because of its foreign nature does not automatically exempt it from the antifraud provisions of the securities laws, and that there may be factual situations in which an exempt offering could violate such antifraud provisions. That is vastly different from any suggestion that the SEC may have deemed such provisions to have been violated by the foreign transaction here challenged.

Had the SEC deemed that non-resident aliens who purchased IOS shares abroad had a cause of action for violation of the antifraud provisions of the federal securities laws and that the Court of Appeals' decision constituted an "erroneous and dangerous precedent", the SEC would certainly have joined in petitioner's efforts to obtain rehearing before the Court of Appeals, as the SEC has done in other situations.

(4) The Court of Appeals properly held that the proposed class is unmanageable.

Petitioner also challenges the holding below that a class consisting of over 96,600 non-resident aliens, residing in some 44 countries in Europe, Asia, Africa, Australia and South America, who bought stock of a foreign corporation outside the United States, is unmanageable,—an unmanageability which the Court of Appeals illustrated by reference to the notice and language problems, and the fact that "notice only in English" would not be justified, whereas a notice "sent in several languages" presents a problem of insuring accuracy (41b, fn. 47).

The Court of Appeals was also concerned with the fact that the uncontradicted evidence established that numerous foreign countries in Europe, Asia, Africa, Australia and South America in which the putative class members reside

would not recognize a United States judgment in favor of a defendant as a bar to an action by their own nationals, even if such persons received actual notice that they were members of the class, and would be bound by a judgment unless they opted out. The Court of Appeals noted with approval a statement in an earlier District Court opinion in this case, not included in the appendix to the petition, that "if defendants prevail against a class they are entitled to a victory no less broad than a defeat would have been" (42b),—a result impossible to achieve as to the non-resident aliens.

(5) It was proper for the Court of Appeals to decide class action issues.

Petitioner chides the Court of Appeals for considering class action issues "without receiving the views of the appellee on the issue" (Pet. 69), and claims that he was misled into believing that such issues were not before the Court, when it refused to consolidate the appeal with another appeal in which class action issues were involved and also when it refused to allow Andersen "to submit an oversize brief so as to present class action issues" (Pet. 69). A complete answer to this farfetched position is that Andersen's brief in the Court of Appeals devoted some 25 printed pages to class action issues, which petitioner refused even to consider in his brief. The Court of Appeals, in dealing with such refusal, stated (39b):

> "Regrettably plaintiff has not favored us with a response, preferring to rest on his claim, with which we disagree for reasons just developed, that the issue is not before us."

Also, it is so clear that a class of 100,000 members, over 99.6% of which are non-resident aliens, residing in 44 countries, including Europe, Africa, Asia, Australia and South America, and speaking a variety of foreign languages, is unmanageable and that such non-resident aliens can in no event be bound by a judgment, that petitioner's strategy

of disregarding these issues is based on inability to present a sound opposing position, and not on sincere conviction that class action issues were not before the Court of Appeals, and that it was estopped from considering such issues when presented by Andersen.

(6) Petitioner's personal attack on Judge Friendly is scandalous.

Finally, petitioner seeks certiorari on the ground that Judge Friendly, who wrote the Court's opinion and, presumably, unfairly influenced his two brethren on the panel, has "an antipathy toward class actions" (Pet. 29), and that his opinion is based "primarily upon the prejudices of its author with respect to class actions" (Pet. 30). The petition irrelevantly argues that Judge Friendly "considers the settlement of class actions 'blackmail' ", citing his book on *Federal Jurisdiction: A General View*, 120 (1973) (Pet. 68). The scandalous matter in this petition should suffice to warrant its being stricken by the Court (Rule 40).

However, to illustrate the type of distortion which permeates the petition, it may be noted that Judge Friendly's book on Federal Jurisdiction merely referred to a particular and, unfortunately, all too common, type of situation, which he described as follows:

> "While the benefits to the individual class members are usually minuscule, the possible consequences of a judgment to the defendant are so horrendous that these actions are almost always settled. Generally, this is for a figure constituting a small fraction of the amount claimed but large enough to yield compensation to the plaintiffs' lawyers which seems inordinate even in these days of high legal fees" (at pp. 119-120).

Despite the self-righteousness of petitioner's attorney, his conduct in this case exemplifies Judge Friendly's statement.

The claim in this case is for $110,000,000 plus interest, attorneys' fees and disbursements. According to the complaint and the petition, the principal wrongdoers are the six underwriters, particularly Drexel and Smith Barney, whose "participation", petitioner asserts, "was essential to the success of the IOS Public Offering", and who "lent their prestige and capital to the offering and augmented its American image" (Pet. 7). Yet, petitioner's counsel has entered into a proposed settlement agreement with these six underwriters to settle the $110,000,000 claim against them for only $700,000 (13b-14b).

On the other hand, for a case in which there was no discovery on the merits and which was in a very preliminary stage, under the proposed $700,000 settlement petitioner's counsel would receive a $200,000 fee and $10,000 reimbursement of expenses (14b). The settling defendants,—the underwriters with the primary responsibility in this matter, who realized the major profit on the underwriting,—would thus pay substantially less than the anticipated cost of defending the action.

The proposed settlement is approximately one half of one percent of the claim. With 100,000 class members and 11,000,000 shares sold, the average recovery for each class member would be less than $5.00, and the average recovery per share would be less than five cents. Accordingly, what petitioner is here seeking to accomplish is the clearest evidence in support of Judge Friendly's above-quoted statement as to class actions, for which he is so roundly chided by petitioner's counsel.*

* The personal attack on Judge Friendly in the petition, unseemly as it is, is substantially more restrained than in the petition for *in banc* rehearing in the Court of Appeals, dated May 9, 1975. That petition for rehearing, which was primarily a personal attack on Judge Friendly, states that the Court of Appeals' decision represents "the personal predilections of Judge Friendly and his bias toward class actions" (p. 3); "is characterized by a parochial outlook" (p. 4); that Judge Friendly is "insensitive to the rights of individuals," and that his opinion is premised "on the prejudices of its author with respect to class actions" (p. 4); that "Judge Friendly's free-wheeling interpretation of Congressional 'intent' constitutes only an expression of his own

Conclusion

The petition states nothing which warrants review by this Court, on the basis of the considerations governing review on certiorari set forth in Rule 19 or otherwise, and there are no special or important reasons for granting the writ. Also, the decision of the Court of Appeals is correct in all respects. Accordingly, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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views" (p. 6), as though his two distinguished colleagues who concurred in the decision had no independent views and were Judge Friendly's puppets; that Judge Friendly substituted for the language of the statute "his own judicial creation of artificial categories" for the statutory language (p. 8); that Judge Friendly was seeking "to achieve the scheme of society which he entertains" (p. 20); that he had "an ulterior motive, perhaps sub-conscious" (p. 21); that his opinion was based on "bias" (p. 22); that his motive is to "turn the clock back to the days before class actions" (pp. 24-25); and that "admittedly",—without pointing to any place where this admission was made,—Judge Friendly's opinion does not represent "the view of Congress, but the opinion of a judge who is no longer an active member of this court" (p. 25), suggesting possible superannuation. Finally, the petition concludes with repetition of the charge that the opinion is based upon "personal prejudices" (p. 25). Petitioner's counsel's disappointment over loss of his $200,000 fee can hardly justify his unrestrained attack on one of the most distinguished jurists of this country.